Fiscal Note 2013 Biennium

GOVERNOR'S OFFICE OF
BUDGET AND PROGRAM PLANNING

Bill #	SB0392	**Title:**	Revise tax laws related to class eight property tax exemptions
Primary Sponsor:	Gillan, Kim	**Status:**	As Introduced

- ☑ Significant Local Gov Impact
- ☑ Needs to be included in HB 2
- ☑ Technical Concerns
- ☐ Included in the Executive Budget
- ☑ Significant Long-Term Impacts
- ☐ Dedicated Revenue Form Attached

FISCAL SUMMARY

	FY 2012 Difference	FY 2013 Difference	FY 2014 Difference	FY 2015 Difference
Expenditures:				
General Fund	$5,750,822	$7,902,474	$1,151,185	$1,284,983
Revenue:				
General Fund	($1,395,995)	($3,812,984)	($5,112,598)	($5,674,602)
State Special Revenue	($87,414)	($260,164)	($380,667)	($445,401)
Net Impact-General Fund Balance:	($7,146,817)	($11,715,458)	($6,263,783)	($6,959,585)

Description of fiscal impact: SB 392 incrementally increases the tax exemption for class 8 business equipment by increasing the aggregate market value threshold from $20,000 to $200,000 in TY 2012 to $500,000 in TY 2013, and $1.0 million for TY 2014 and thereafter. This reduces class 8 and class 12 taxable value and reduces general fund and 6-mill university levy state special revenue. Additionally, SB 392 provides contingency language requiring revenue reimbursement for loss of tax base in TY 2012 to local schools, local governments, and Tax Increment Financing Districts (TIF's) totaling $6.9 million in FY 2012 and $8.8 million in FY 2013.

FISCAL ANALYSIS

Assumptions:

Department of Revenue (DOR)

1. SB 392 raises the market value exemption threshold for class 8 (business equipment) to $0.2 million in TY 2012, $0.5 million in TY 2013, and $1.0 million in TY 2014 and beyond.
2. The bill is effective July 1, 2011, and applies to tax years starting with TY 2012.

Class 8 (Business Equipment) Taxable Value Reduction

3. TY 2010 taxable value of all class 8 property was used to model the impact of SB 392 increases in taxable market value thresholds. The current TY 2010 taxable value of class 8 property is $176,107,343.
4. The TY 2010 taxable value of class 8 property was estimated for each incremental threshold prescribed in the SB 392 and results in the following class 8 property taxable value, in TY 2010 values. The following table shows the total taxable value of class 8 property remaining after all eligible property has been exempted.

Modeled Class 8 Taxable Value Changes SB 392 as Introduced

Schedule	Taxable Market Value Threshold	TY 2010 Taxable Value	Change from Current Law	Year to Year
Current Law	$20,000	$176,107,343	0%	$0
SB 372 - TY 2012	$200,000	$146,772,932	-16.7%	-16.7%
SB 372 - TY 2013	$500,000	$128,515,473	-27.0%	-12.4%
SB 372 - TY 2014	$1.0 million	$118,505,203	-32.7%	-7.8%
SB 372 - TY 2015	$1.0 million	$118,505,203	-32.7%	0.0%

5. The current law and SB 392 (TY 2010) schedule of taxable value are projected using HJR 2 growth rates for TY 2011, TY 2012, and TY 2013 and the Office of Budget and Program Planning (OBPP) growth rates for TY 2014 and TY 2015. The growth rates are as follows.

HJR 2 Average Growth Rates for Property Tax Class 8 and Class 12 Revenue Effects

Property Type	FY 2012	FY 2013	FY 2014	FY 2015
Class 8	7.50%	5.00%	5.00%	5.00%
Class 12	2.10%	1.20%	2.10%	2.10%

6. Taxable value change was modeled using TY 2010 data, the SB 392 thresholds, and HJR 2 and OBPP growth rates for the respective years covered by this bill. Taxable value change is then calculated by subtracting current law taxable value from SB 392 estimated taxable value.

Change in Class 8 Taxable Value SB 392 as Introduced

Tax Year	TY 2012	TY 2013	TY 2014	TY 2015
Class 8 Taxable Value (Current Law)	198,781,163	208,720,221	219,156,232	230,114,044
Class 8 Taxable Value (SB 392)	165,669,948	152,314,932	147,473,429	154,847,100
Difference (SB 392 - Current)	**(33,111,216)**	**(56,405,290)**	**(71,682,803)**	**(75,266,944)**
% Difference	-16.66%	-27.02%	-32.71%	-32.71%

7. The effect of SB 392 is to raise market value threshold for taxable property progressively, thus lowering taxable value relative to current law, SB 392 reduces the taxable value of class 8 property incrementally from TY 2012 to TY 2014 when the $1.0 million threshold remains constant in subsequent years. This results in an approximately 32.7% reduction in taxable value.

Class 12 Taxable Value Reduction (Railroad and Airline Property)

8. The class 12 (railroad and airline property) tax rate is calculated as the statewide average tax rate for all other commercial and industrial property in the state (class 4 commercial property, and classes 8, 9, 13, 14, 15, and 16). The reduction in class 8 taxable value under SB 392 results in a decrease in the weighted average tax rate for class 12. The TY 2010 tax rate for class 12 property was 3.40%. Recalculating the tax rate with the reduced taxable values for class 8 property resulting from this bill would decrease the class 12

tax rate beginning in TY 2013 (FY 2014) as the calculation is based on the prior tax year's weighted average. The effect is presented in the following table:

Change in Class 12 Taxable Value Due to Class 8 Reductions under SB 392 as Introduced				
Fiscal Year	**TY 2012**	**TY 2013**	**TY 2014**	**TY 2015**
Class 12 Market Value	$1,566,561,450	$1,585,360,187	$1,618,652,751	$1,652,644,459
Current Law Tax Rates	3.38%	3.33%	3.28%	3.26%
Tax Rate with HB 392 Class 8 Changes	3.38%	3.31%	3.22%	3.18%
Class 12 Taxable Value (Current Law)	$52,949,777	$52,792,494	$53,094,233	$53,879,673
Class 12 Taxable Value (SB 392)	$52,949,777	$52,475,422	$52,120,619	$52,554,094
Class 12 Taxable Value Difference	**$0**	**($317,072)**	**($973,615)**	**($1,325,579)**
% Difference (Bill - Current Law)	0.00%	-0.60%	-1.83%	-2.46%

Rail Car Tax Revenue Impact

9. The reduction in the class 12 tax rate reduces the state general fund tax on railroad cars. The rolling stock of railroad car companies are taxed based on the Montana allocated value of the national railroad car fleet, taxed at the class 12 tax rate, and the average statewide commercial and industrial mill rate. The impact of the change in the tax rate based on the HJR 2 and OBPP assumptions for the growth in Montana allocated value and mill rates is presented below:

Change in Rail Car Tax under SB 392 as Introduced				
	FY 2012	**FY 2013**	**FY 2014**	**FY 2015**
Montana Allocated Value	$118,886,000	$122,929,000	$123,485,000	$124,041,000
Current Law Class 12 Tax Rate	3.38%	3.33%	3.28%	3.26%
Class 12 Tax Rate SB 392	3.38%	3.31%	3.22%	3.18%
Current Law Taxable Value	4,018,347	4,093,536	4,050,493	4,043,997
Taxable Value under SB 392	4,018,347	4,068,950	3,976,217	3,944,504
Taxable Value Difference	$0	(24,586)	(74,276)	(99,493)
Statewide Mills	521.50	526.30	531.26	536.22
Revenue Change	**$0**	**($12,940)**	**($39,460)**	**($53,350)**

Projection of State Property Tax Revenue Impact

10. Based on preceding taxable value reduction estimates for class 8 property and class 12 property the following table shows the anticipated reduction in state revenue under SB 392 for FY 2012 through FY 2015.

Change in State Property Tax Revenue under SB 392 as Introduced

Change in Taxable Value		**TY 2012**	**TY 2013**	**TY 2014**	**TY 2015**
Class 8		(33,111,216)	(56,405,290)	(71,682,803)	(75,266,944)
Class 12		0	(317,072)	(973,615)	(1,325,579)
FY Revenue	**Mills**	**FY 2012**	**FY 2013**	**FY 2014**	**FY 2015**
General Fund					
Class 8	95.82	($1,395,995)	($4,154,813)	($6,048,867)	($7,019,756)
Class 12	95.82	$0	$0	($30,382)	($93,292)
Total		**($1,395,995)**	**($4,154,813)**	**($6,079,249)**	**($7,113,048)**
State Special Revenue					
Class 8	6.00	($87,414)	($260,164)	($378,764)	($439,559)
Class 12	6.00	$0	$0	($1,902)	($5,842)
Total		**($87,414)**	**($260,164)**	**($380,667)**	**($445,401)**

11. These projections are adjusted for the fiscal year receipt of property tax. Most property taxes are paid in November and May of the fiscal year following assessment. However, under the provisions of 15-16-119, MCA, owners of personal property that is not liened-to-real property (Class 8) pay property taxes 30-days after assessments are mailed in March. This means that not liened-to-real property taxes are paid in the fiscal year they are billed. In TY 2010, class 8 property not liened-to-real property made up 44.0% of the total value of class 8 property. It further means that 56.0% of TY 2011 property taxes are paid in FY 2012.
12. This bill would reduce class 8 taxable values starting in TY 2012. The impact would start in FY 2012 for personal property not liened-to-real property (44% of TY 2012 property), and in FY 2013 for all property.

<u>*Business Tax Revenue Increase*</u>

13. With lower property taxes, businesses will have lower property tax expenses to deduct in calculating taxable net revenue. The estimated reduction in net property tax is calculated based on the state and local property tax reductions estimated in this fiscal note.
14. Corporations that do business in Montana and other states are required to report their Montana property on their corporation license tax returns. Of this property, 66.65% was reported by corporations that had positive taxable income. It is assumed that the same proportion of total business property is owned by businesses with positive net income.
15. Each calendar year, the reduction in business expenses is half of the reduction in property tax for profitable businesses for the same numbered fiscal year plus half of the reduction for the next fiscal year.
16. The corporation license tax rate is 6.75%. It is assumed that the average marginal tax rate on business income reported on individual income tax returns is also 6.75%.
17. Businesses frequently use the option for an extended deadline for filing tax returns. Because of this, the changes in tax liability will be reported on tax returns filed over the course of the following calendar year, with half of the change coming in the fiscal year including the last half of the tax year and half coming in the next fiscal year. The result is presented in the following table:

Estimated Business Tax Revenue Increase Under SB 392 as Introduced

Property Tax Reduction		**TY 2012**	**TY 2013**	**TY 2014**
State		(2,949,193)	(5,437,446)	(7,009,182)
Local Government		(6,188,323)	(11,407,922)	(14,701,215)
Schools		(6,157,621)	(11,351,642)	(14,629,575)
TIFs		(476,322)	(875,592)	(1,121,436)
Decrease in Property Tax Liability		($15,771,460)	($29,072,603)	($37,461,409)
	FY 2012	**FY 2013**	**FY 2014**	**FY 2015**
Increase in Business Taxes	**$0**	**$354,769**	**$1,006,111**	**$1,491,797**

18. The total property tax revenue losses are estimated using the taxable value change and the statewide weighted average mills for each level of government. These revenue reductions before reimbursements are estimated and presented below. Note that taxable value reductions are presented on a tax year basis, the revenue reductions are presented by fiscal year of impact:

Net Impact on Local Government Taxable Value and Revenue - SB 392 as Introduced

Change in Taxable Value		**TY 2012**	**TY 2013**	**TY 2014**	**TY 2015**
Class 8		(33,111,216)	(56,405,290)	(71,682,803)	(75,266,944)
Class 12		0	(317,072)	(973,615)	(1,325,579)
Taxable Value Reduction		**(33,111,216)**	**(56,722,362)**	**(72,656,418)**	**(76,592,523)**
Fiscal Year Tax Revenue	**Mills**	**FY 2012**	**FY 2013**	**FY 2014**	**FY 2015**
School Districts					
Class 8 Property	212.59	($3,097,210)	($9,218,032)	($13,420,253)	($15,574,306)
Class 12 property	205.00	$0	$0	($65,000)	($199,591)
Total School Districts		**($3,097,210)**	**($9,218,032)**	**($13,485,253)**	**($15,773,897)**
Local Governments					
Class 8 Property	213.65	($3,112,653)	($9,263,994)	($13,487,168)	($15,651,962)
Class 12 property	204.00	$0	$0	($64,683)	($198,617)
Total Local Governments		**($3,112,653)**	**($9,263,994)**	**($13,551,851)**	**($15,850,579)**
Tax Increment Districts					
Taxable Value in TIFs (3.15% of Class 8)		($1,043,003)	($1,776,767)	($2,258,008)	($2,370,909)
Class 8 Property	522.06	**($239,585)**	**($713,060)**	**($1,038,123)**	**($1,204,750)**
Total Revenue Reduction		**(6,449,447)**	**(19,195,086)**	**(28,075,227)**	**(32,829,226)**

19. This bill provides contingency language voiding this bill if reimbursement is not provided for school districts, local governments, and tax increment financing districts for the loss of TY 2012 tax base. The bill provides for reimbursement of the direct revenue loss to each level of government in FY 2012 and FY 2013 through contingent voidness language in the bill. The following table presents the estimated required reimbursement for each level of government:

Reimbursements for the Change in Taxable Value Under SB 392 as Introduced

Reimbursement Jurisdiction	**FY 2012**	**FY 2013**	**FY 2014**	**FY 2015**
Reimbursement Year	**TY 2012**	**TY 2012**		
and Fiscal Year Share	44%	56%	0%	0%
School Districts	$3,097,210	$3,941,903	$0	$0
Local Governments	$3,112,653	$3,961,558	$0	$0
Tax Increment Districts	$239,585	$304,926	$0	$0
Total Property Tax Reimbursements	**$6,449,447**	**$8,208,388**	**$0**	**$0**

Department of Revenue Administrative Expenses

20. Because SB 392 raises the threshold for class 8 property taxable market value in stages, the department will need to make programming changes in the property tax database system. The department assumes these changes will cost $1,320 in FY 2012.

21. The decrease in property tax revenues due to this bill for not liened-to-real property in FY 2012 does not have a Guaranteed Tax Base Aid (GTB) effect on K-12 schools because GTB would have been determined before the bill is effective in FY 2012.
22. The loss of taxable value occurs in annual steps in TY 2012 through TY 2015. There could be GTB cost adjustments each year for FY 2013 through FY 2015 related to this bill. These cost adjustments could be offset because the bill directs the reimbursement payments to be considered non-levy revenue for school budgeting purposes. Non-levy revenues are considered prior to GTB calculation in school budgeting. Therefore the reimbursement goes into school district base reducing GTB costs.
23. There could also be countywide retirement GTB effects. These are assumed to be proportionate (at FY 2010 levels) with respect to statewide GTB payments ($30 million retirement GTB cost/$140 million GTB costs) GTB costs are presented in the following table:

Net GTB Impact from Loss of Taxable Value and Property Tax Base Reimbursements under SB 392 as Introduced

	FY 2012	FY 2013	FY 2014	FY 2015
GTB Costs	$0	$643,960	$948,034	$1,058,221
Reimbursement Effect	($699,946)	($895,890)	$0	$0
Net GTB effects	**($699,946)**	**($251,929)**	**$948,034**	**$1,058,221**
Retirement GTB Estimate	**$0**	**($53,985)**	**$203,150**	**$226,762**

Department of Revenue

Fiscal Impact:	**FY 2012 Difference**	**FY 2013 Difference**	**FY 2014 Difference**	**FY 2015 Difference**
Expenditures:				
Operating Expenses	$1,320	$0	$0	$0
Contingent Appropriation:				
Local Governments	$3,112,653	$3,961,558	$0	$0
Tax Increment Districts	$239,585	$304,926	$0	$0
TOTAL Expenditures	$3,353,557	$4,266,484	$0	$0
Funding of Expenditures:				
General Fund (01)	$3,353,557	$4,266,484	$0	$0
TOTAL Funding of Exp.	$3,353,557	$4,266,484	$0	$0
Revenues:				
General Fund - Property Tax	($1,395,995)	($4,154,813)	($6,079,249)	($7,113,048)
General Fund - Business Income Ta	$0	$354,769	$1,006,111	$1,491,797
General Fund - Rail Car Tax	-	($12,940)	($39,460)	($53,350)
SSR(02) - Property Tax	($87,414)	($260,164)	($380,667)	($445,401)
TOTAL Revenues	($1,483,409)	($4,073,148)	($5,493,264)	($6,120,002)

Office of Public Instruction:

Expenditures:				
Contingent Appropriation:				
Local Assistance (All Funds)	$3,097,210	$3,941,903	$0	$0
Local Assistance (GTB)	($699,946)	($251,929)	$948,034	$1,058,221
Local Assistance (Co. Retirement)	$0	($53,985)	$203,150	$226,762
TOTAL Expenditures	$2,397,264	$3,635,989	$1,151,184	$1,284,983
Funding of Expenditures:				
General Fund (01)	$2,397,264	$3,635,989	$1,151,184	$1,284,983
TOTAL Funding of Exp.	$2,397,264	$3,635,989	$1,151,184	$1,284,983

Net Impact to Fund Balance (Revenue minus Funding of Expenditures):

General Fund (01)	($7,146,817)	($11,715,457)	($6,263,782)	($6,959,585)
State Special Revenue (02)	($87,414)	($260,164)	($380,667)	($445,401)
Federal Special Revenue (03)				
Other				

Effect on County or Other Local Revenues or Expenditures:

1. This bill may lead to increases in local school mills in districts with high proportions of class 8 property and class 12 property as budgets are adjusted to make-up for the partial reimbursement provided by SB 392 contingent appropriation language and reductions in taxable value.
2. The decrease in local school revenue and local government revenue will lead to tax shifts as tax obligations are passed from class 8 property and class 12 property to other property classifications. TIFs would see shifts as local and school mills rise. TIFs would share in the 95 mill revenue reductions. The unreimbursed property tax revenue – before tax shifts – are estimates to be as follows:

Unreimbursed Portion of Taxable Value Reduction Under SB 392 as Introduced

Reimbursement Jurisdiction	FY 2012	FY 2013	FY 2014	FY 2015
School Districts	$0	$5,276,128	$13,485,253	$15,773,897
Local Governments	$0	$5,302,436	$13,551,851	$15,850,579
Tax Increment Districts	$0	$408,135	$1,038,123	$1,204,750
Property Tax Reimbursements	**$0**	**$10,986,699**	**$28,075,227**	**$32,829,226**

Long-Term Impacts:

1. After completing the incremental increase in market value exemption SB 392 removes approximately 32.7% of class 8 taxable value and 2.5% of class 12 taxable value from the taxation system.

Technical Notes:

Department of Revenue

1. Section 1, page 2, line 22-24(5)(a) requires the department to calculate a growth proxy for each taxing jurisdiction using the actual taxable value of class eight property in tax year 2011. A specific point in time could be designated for clarification. For example, the taxable value as certified to the county, or the taxable value as of December 31.
2. Section 3, page 6, lines 25-30 repeat almost verbatim the language in 15-8-301(3) and (4), MCA. However, this bill does not modify 15-8-301, MCA, to eliminate the redundancy.
3. SB 392 retains the existing bonding capacity for local governments and schools and retains the status quo for the classification of a county based on "taxable value" by treating them "as if" they still have the taxable value represented by the exempted property amounts allowing local government and schools to issue debt resulting in larger debt-to-taxable value ratios than currently exists. It is conceivable that bond counsel could raise issues about adequate security with respect to particular bond issues given that under the bill the debt issuers will not be reimbursed by the state past TY 2012.
4. SB 392 applies the exemption amount to "multiple entities that are functionally a single business" and requires DOR to adopt rules to stop taxpayers from forming entities to avoid the cap (because a business with $999,999 of class 8 property in TY 2014 exempts $999,999 of the property under this bill while a company with $1,001,000 of class 8 property exempts $0 class 8 property, businesses with property at the upper end of that year's limit will have incentive to not to exceed the threshold.
5. Section 3, page 6, lines 16-21 requires the department to establish reporting requirements that will "prevent multiple business entities from being formed . . .". The requirements of lines 16-21 will be challenging to implement and enforce. It's unlikely that the department can prevent business entities from being formed or can substantiate that the motive for a business entity's formation was to benefit from the class 8 exemption threshold.

6. SB 392 contains a contingent voidness section if funding is not obtained ($6.9 million for FY ending 2012 and $8.8 million for FY ending 2013) for the reimbursement of local jurisdictions for the loss of TY 2012 tax base.
7. HB 392 may have constitutional issues, including equalization and equal protection, and may violate the Railroad Revitalization and Regulatory Reform (4-R) Act because it exempts business personal property that is currently assessed as class eight, but does not repeal the tax obligation for similar business personal property that is or may be assessed in other classes, specially: four, five, six, seven, nine, twelve, thirteen, or fourteen.

Sponsor's Initials	*Date*	*Budget Director's Initials*	*Date*